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UNCLAS SECTION 01 OF 02 JAKARTA 002470

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SUBJECT: DAS MARCIEL MEETINGS ON INDONESIA'S ECONOMY,
INVESTMENT CLIMATE

REF: A. A) JAKARTA 2069 (NIKE CASE)

[1](#)B. B) JAKARTA 2097 (COUNTERFEIT PHARMACEUTICALS)

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[1](#)1. (SBU) Summary. EAP Deputy Assistant Secretary Scot Marciel, during his August 27-28 visit to Jakarta, heard complaints that Indonesia is not attracting as much investment as neighbor Vietnam. Reasons include the Indonesian government and Parliament's ambivalence towards foreign companies and punitive actions such as threatening or jailing foreign business executives during contract disputes. Domestic and international companies are often frustrated by regulations issued without a consultative process. While growth is good, a better business climate could improve investment and infrastructure. End Summary.

Investment Still Sluggish

[1](#)2. (SBU) At a working dinner on economic issues, a prominent businesswoman noted that media stories about Indonesia are all negative. The media was suppressed under Soeharto, but now it publishes bad news, so that is what readers see. Investors want a sense of security for their potential investments and read these reports with concern. One GOI official believed that growth is fast enough, stating "growth is already at 6%. If we grow at 8% we will overheat." A member of Parliament (DPR) noted that plenty of short-term portfolio investment is coming in, but not long-term.

[1](#)3. (SBU) On infrastructure projects, Marsillam Simanjuntak, a Presidential advisor, said that the GOI's policies on infrastructure are flawed. He asked, "Why do 10,000 MW electricity projects need a government guarantee? China, Japan and EU companies all participated in the tender, but after China won, it requested a guarantee. This creates a discrepancy of trust." He concluded the GOI has not yet found a way to balance its legitimate need for power with "vested interests." The Commissioner from a state-owned enterprise said that Indonesia's state-owned sector should be in the hands of the public, not the government. Conflicts of interest cannot be resolved under the current system.

[1](#)4. (SBU) DAS Marciel and the Ambassador noted that bad media stories about Indonesia are discouraging to investors, who are "waiting to see." A certain momentum of good news

stories is necessary to attract attention. The lack of legal certainty has a chilling effect, such as the GOI appeal of the Newmont verdict in the Buyat Bay case. Ongoing IPR problems also dampen enthusiasm for Indonesia, such as the GOI's rampant use of pirated Microsoft software and the large percentage (20-25%) of counterfeit pharmaceuticals. The Ambassador said that U.S. company executives here are afraid of incarceration if they have a contract dispute such as Nike recently experienced (ref A). Actions like these could cause wider harm as investors may consider shutting down all operations in Indonesia.

Business Wants More Consultation with GOI

15. (SBU) American Chamber of Commerce (AmCham) members are optimistic about expanding their businesses but still frustrated at the lack of regulatory consultation. Laws and regulations are largely being written with no connection to the reality of the sectors they impact. Many GOI regulations are "neither implementable nor enforceable," one representative of a pharmaceutical company noted. Several DPR members also have a streak of economic nationalism with an attitude towards foreign investors of, "We want your money, but we don't want you." "We are expanding, but we could do more if the environment was easier," the AmCham President noted. AmCham said that domestic companies are equally concerned about the business climate, with legal uncertainty high on the list. IPR issues are still a huge concern. The biggest raid in history of counterfeit pharmaceuticals (ref B) is "just the tip of the iceberg." In the telecommunications sector, options for U.S. companies are now only in services not in infrastructure.

Economic Advisor - Getting Enough Growth

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15. (SBU) The Director of the Institute for Social and Economic Research at the University of Indonesia, Dr. Chatib Basri, also serves as an advisor to the Economic Cabinet Ministers and to President Yudhoyono. Dr. Basri said the biggest concern to the GOI's economic leaders is whether growth will be strong enough to create jobs. There is conflict between the Ministry of Industry, which seeks protections, and the Ministry of Trade, which wants a more open trading policy. Domestic companies fear competition. The problem is not the demand side: exports are doing well and will continue to do so as long as China maintains growth. The supply side constraints include transportation and energy infrastructure: a lack of good roads and adequate electricity, for example. Foreign direct investment from the U.S. is also problematic. Embassy Econ officers raised the problems we've had with exploratory discussions on a Bilateral Investment Treaty and with an updated Overseas Private Investment Corporation (OPIC) agreement. Dr. Basri said that, "Many in the GOI view it as politically negative to be seen doing deals with the U.S. Major political players such as Amien Rais say that everything related to the U.S. is bad."

16. (SBU) Dr. Basri said that labor conditions are also problematic. After Bolivia and Portugal, Indonesia has the highest severance rates in the world. This acts as a kind of "tax on business" and companies thus prefer to hire temporary workers. Labor reform is too politically sensitive to tackle, however. Unemployment in the formal sector and underemployment is still high, but because there is no social security, "only the rich can afford to be unemployed." To alleviate rural poverty, Basri suggested to the President a kind of employment scheme for rural infrastructure at below minimum wages in order to attract those truly below the poverty line into wage-paying jobs.

17. (SBU) Corruption still contributes to the cost of doing

business but has reduced dramatically: bribes added about 12% to the cost of production in 2001 but fell to 6% in 2005.

There is not yet a good incentive system for Indonesian civil service officials to improve their performance, Dr. Basri noted. Under Soeharto, the incentive system to implement the President's priorities was clear: promotion or jail. Streamlining government is starting to reduce extra, corrupt sources of income. The GOI needs to find a way to bring in "sweeteners" for motivation, Dr. Basri believes. In terms of good civil service internal controls and budget practices, "We're still with the dinosaurs," Dr. Basri noted.

Local governments are producing bad regulations because there is no consultation process or regulatory impact assessment. Some are trying to make improvements, however. One way to promote change may be to support reform-minded local officials who are moving fastest to improve the business climate.

Biofuels and Climate Change

18. (SBU) On biofuels, Dr. Basri said that he was, "skeptical from the Qtset," since the President wanted to use this program mainly for employment generation. Dr. Basri believes an alternative fuel program will not work until the administered prices for fuel subsidies are fully removed. In his view, the program will neither produce an economically sound product nor will it create jobs in the way the President originally conceived it. Dr. Basri was tasked by the Ministry Finance to draft a paper on climate change for the UN Framework Conference on Climate Change 13th Conference of Parties (UNFCCC COP-13) conference in Bali December 3-14. Embassy will follow up with Dr. Basri to get an advance copy.

HUME